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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & Co.,

Petitioner,

—v.—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT—SECURITIES INVESTOR PROTECTION CORPORATION

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Preliminary Statement

This brief is submitted by respondent Securities Investor Protection Corporation ("SIPC") in opposition to the brief of petitioner Touche Ross & Co. ("Touche Ross"). SIPC was created by and organized under the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa *et seq.* ("SIPA").[1]

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[1] SIPA was recently amended by the Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249 *et seq.*

A separate brief is being submitted by SIPC's co-plaintiff, Edward S. Redington (the "Trustee"). The Trustee was appointed in May 1973 by order of the United States District Court for the Southern District of New York to liquidate the business of Weis Securities, Inc. ("Weis"), pursuant to SIPA.

SIPC and the Trustee have sought to avoid duplication wherever possible.

Additional Statute Involved

Section 27 of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78aa, is set forth in the appendix to this brief.

Counterstatement of Questions Presented

1. Whether a private right of action based on Section 17(a) of the 1934 Act may be asserted by customers of a brokerage firm against the firm's accountant for losses resulting from the accountant's false certification of reports filed with regulatory agencies pursuant to Section 17(a)?

2. Whether SIPC, which is required by SIPA to advance funds to the Trustee for the payment of claims made by a liquidated brokerage firm's customers, is subrogated to the customers' Section 17(a) right of action against the accountant?

Counterstatement of the Case

This action arises from the audit in May 1972 of Weis, a securities brokerage firm, by Touche Ross, a firm of certified public accountants. Touche Ross was hardly a

stranger to the operations, personnel and financial affairs of Weis when it performed the 1972 audit. For at least four years, Touche Ross had served as Weis' "independent" certified public accountant. In that capacity, Touche Ross purported to audit the affairs of Weis on an annual basis, as required by Section 17(a) of the 1934 Act, the applicable standards of the accounting profession, and the audit regulations of the Securities and Exchange Commission (the "SEC") and the New York Stock Exchange (the "Exchange").

Certain of Weis' officers (the "Weis Five") successfully conspired to conceal substantial operating losses during fiscal year 1972 by falsifying the financial reports required to be filed with the regulatory authorities pursuant to Section 17(a) of the 1934 Act. The devices employed and the transactions involved in the fraud perpetrated by the Weis Five on the public are alleged in great detail in the complaint (A. 8 [¶ 10], 9 [¶ 12], 16 [¶ 29]).[2] For example, Weis' pre-tax earnings were misstated as in the range of $1,700,000 where, in fact, Weis suffered losses in excess of $1,500,000. Thus, at the very least, this action involves Touche Ross' false certification of a 3.2 million dollar fraud.

By the time Weis' true financial condition was finally exposed in 1973, Weis' forced liquidation had become inevitable. Hence, the SEC commenced an action in the United States District Court for the Southern District of New York for injunctive relief to prevent the Weis Five from conducting the business of Weis in violation of the 1934 Act and the rules and regulations promulgated thereunder. SIPC applied to the same Court for a decree adjudicating that Weis' customers were in need of the

[2] Numerals preceded by the letter "A." refer to the pages of the separate Appendix filed with the Court. The facts summarized herein are those alleged in the complaint (A. 5-33).

protection afforded to them by Congress in SIPA.[3] The decree was granted, the liquidation of Weis was ordered, and the Trustee was appointed to liquidate the business of Weis. Consequently, SIPC was required by SIPA to provide, and did provide, to the Trustee at least fourteen million dollars for the payment of liquidation claims submitted by Weis' customers.

The means by which Weis' massive fraud was perpetrated on the SEC, the Exchange, SIPC and Weis' customers were the reports Weis was required to file with the SEC and the Exchange pursuant to Rule 17a-5, promulgated under Section 17(a) of the 1934 Act. These reports play a role of paramount importance in the scheme devised by Congress in the 1934 Act and SIPA, and effectuated by the regulatory authorities, for the protection of customers who entrust their cash and securities to broker-dealers. Weis was a member of SIPC, but SIPC has no authority to examine its members.[4] Rather, it relies entirely on the self-regulatory organization to which the SIPC member belongs (in the case of Weis, the Exchange) to examine the broker-dealer for compliance with the applicable financial responsibility rules, and to alert SIPC to the broker-dealer's financial difficulty. The self-regulatory organization, in turn, relies on the Rule 17a-5 reports certified by the broker-dealer's accountants (here, Touche Ross) to determine whether the broker-dealer is in compliance with these rules and thus financially sound. And, of course, the broker-dealers' customers (to whose rights against wrongdoers SIPC is subrogated here) rely on the efficacy of the statutory and regulatory system created for their protection and are dependent upon the accountants' Rule 17a-5 certifications.

[3] The Weis Five were subsequently indicted and convicted.

[4] SIPC is a quasi-governmental, non-profit membership corporation whose membership consists of virtually all the broker-dealers in this country.

In sum, the protection of the customer (and hence of the SIPC fund) is effectuated only so long as the accountant certifying the Rule 17a-5 reports performs that crucial obligation responsibly. Here, Touche Ross performed that obligation not only irresponsibly, but with such dereliction as borders on, indeed may well constitute, fraud. As a result, Weis' customers—the "favored wards" of Section 17(a) (A. 200)—were deprived of the protection Congress intended them to have when it enacted that statute.

A. *The Basis For The Action Against Touche Ross*

Touche Ross, with full awareness of its public obligations and statutory duties, falsely certified as correct and complete the palpably fraudulent financial statements of Weis. Specifically, based on its audit of Weis for fiscal year 1972, Touche Ross (a) prepared and certified Weis' answers to the financial questionnaire required by the Exchange (A. 42); (b) prepared and certified Weis' financial statements (A. 67); and (c) issued four opinion letters attesting to the accuracy of the financial statements and to the proper discharge of Touche Ross' responsibilities as auditor (A. 37, 45, 69, 87).

The reports of Weis' financial condition at fiscal year-end 1972, required to be filed with the regulatory authorities pursuant to Section 17(a), were intended for, and were relied upon by, SIPC, the Exchange, the SEC, and Weis' customers. Touche Ross certainly knew that these organizations would rely on the results of its audit to determine whether Weis was in compliance with the applicable financial responsibility rules, and to discover whether Weis was in financial difficulty. Similarly, Touche Ross certainly knew that Weis' customers would rely on the audit to determine whether to entrust, or to continue to entrust, their cash and securities to Weis.

Had Touche Ross conducted its audit in the manner which it represented in its opinion letters and certifications, it would have discovered the mammoth fraud perpetrated by the Weis Five and would have had a corresponding legal obligation to disclose it. The components of the fraud are set forth in extraordinary detail in the complaint. *See, e.g.*, A. 16 [¶29].

However, as a direct result of Touche Ross' unjustifiable failure promptly to discover and disclose Weis' true financial condition, any possibility of timely remedial action was lost, Weis was subsequently unable to comply with the minimum financial responsibility rules, and its liquidation became inevitable.

B. *SIPC And Its Claims Against Touche Ross*

As previously noted, SIPC was created and organized under SIPA, the background and purposes of which were summarized by this Court in *SIPC* v. *Barbour*, 421 U.S. 412 (1975), as follows:

> "Following a period of great expansion in the 1960's, the securities industry experienced a business contraction that led to the failure or instability of a significant number of brokerage firms. Customers of failed firms found their cash and securities on deposit either dissipated or tied up in lengthy bankruptcy proceedings. In addition to its disastrous effects on customer assets and investor confidence, this situation also threatened a 'domino effect' involving otherwise solvent brokers that had substantial open transactions with firms that failed. Congress enacted the SIPA to arrest this process, restore investor confidence in the capital markets, and upgrade the financial responsibility requirements for registered brokers and dealers." *Id.* at 415.

The last stated purpose, that of up-grading broker-dealer financial responsibility, was aimed at eliminating "to the maximum extent possible, the risks which lead to customer loss." H.R. Rep. No. 91-1613, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5254, 5255.

SIPA accomplished its purposes essentially by two methods. First, SIPA enhanced the SEC's power to establish financial responsibility rules for broker-dealers, and to impose on the self-regulatory organizations' requirements for the financial examination of their members.[5] This first method by which SIPA's purposes were to be accomplished was subverted by Touche Ross because its false certification of Weis' fraudulent Section 17(a) reports deceived the SEC, the Exchange, SIPC and Weis' customers into assuming that Weis was in compliance with the financial responsibility rules to which it was subject.

The second method by which SIPA accomplished its purposes was the creation of SIPC, which was empowered, *inter alia*, to commence proceedings for the liquidation of its members whose financial condition posed the threat of loss to their customers; and to satisfy, within certain limits, the claims of those customers against the SIPC member's estate. As a result of the belated discovery of Weis' true financial condition and of its consequent liquidation, SIPC advanced over fourteen million dollars to the Trustee for the satisfaction of Weis' customers' claims.

After a lengthy and thorough investigation of the circumstances which brought about the Weis liquidation—and particularly of Touche Ross' role therein—SIPC and the Trustee commenced this action against Touche Ross on April 30, 1976 in the District Court for the Southern District of New York.[6]

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[5] *See, e.g.*, §§ 7(d), 9, 9(e) of SIPA.

[6] SIPC and the Trustee have also commenced a state court action against Touche Ross, which is virtually dormant. That action is

(Footnote continued on next page)

SIPC asserts eight claims in its complaint. Four of these claims are asserted in SIPC's own right (A. 24, 26, 28, 29), and the other four are asserted by SIPC as the subrogee of those Weis customers whose liquidation claims have been satisfied by payments from the SIPC fund (A. 25, 27, 29, 30). Two of SIPC's direct claims and two of its subrogation claims are predicated upon the 1934 Act (A. 24-27), and the remaining four claims plead Touche Ross' common law liability (A. 28-30). Two of the 1934 Act claims assert that Touche Ross aided and abetted the Weis Five's violation of the 1934 Act (A. 26, 27).

The 1934 Act claims are based upon Touche Ross' breach of the duty imposed upon it by Section 17(a), as to which federal jurisdiction is exclusive under Section 27 of the 1934 Act. The common law claims are asserted on the basis of pendent jurisdiction.[7]

C. *The Purpose And Function Of Section 17(a) And Rule 17a-5*

As in effect in 1972, Section 17(a) required broker-dealers to "make such reports, as the [Securities and Exchange] Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors." Pursuant to this provision, the SEC adopted Rule 17a-5 which required broker-dealers to file reports of their financial condition at least annually on a Form X-17A-5.

Prior to the adoption of the rule, the SEC noted that customer protection against the risk involved in leaving securities with broker-dealers would be increased by Rule 17a-5. *National Association of Securities Dealers,* 12 S.E.C. 322, 339 n.9 (1942).

In order to effectuate that purpose of customer protection, Rule 17a-5 called for the gathering, analysis and disclosure of a broad range of information.[8] This information was intended to provide a detailed and complete picture of the financial condition of the broker-dealer, and of the procedures and controls employed by the broker-dealer for safeguarding the property of its customers.

The single most important function of the information filed pursuant to the mandate of Section 17(a) and the requirements of Rule 17a-5 was to assure the SEC and the self-regulatory organizations that the broker-dealer was in compliance with the "net capital" rule, which required the broker-dealer to maintain a certain minimum ratio of liquid assets to aggregate indebtedness.[9] The net capital rule

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(Footnote continued from preceding page)
far less comprehensive than the federal action since no Section 17(a) claims are asserted therein. Moreover, as the Court of Appeals noted: "[T]he state court action was commenced first only in a highly technical sense. It was begun [in July 1975] by service of a summons without complaint (the complaint was not served until after filing of the federal complaint), and then apparently ignored for some months by mutual consent." (A. 195 n.7). It should also be noted that the Court of Appeals, in remanding the federal action, expressly left it for the District Court to decide whether the action should be stayed pending determination of the state court action. Touche Ross has asserted in the state court action that—as a matter of law—it is not liable to third-parties such as Weis' customers and SIPC. See Trustee's Brief at 13-15.

[7] The Court of Appeals expressly left it for the District Court to decide, on remand, whether to exercise pendent jurisdiction over SIPC's common law claims (A. 204).

[8] The discussion herein is with respect to Section 17(a) and Rule 17a-5 as in effect in 1972, at the time of Touche Ross' audit of Weis. Since then, the Rule has been amended to require the gathering, analysis and disclosure of an even broader range of information. Section 17(a) and Rule 17a-5 are included in the appendix to Touche Ross' brief.

[9] As a member of the Exchange, Weis was exempt from the SEC's net capital requirements because it was subject to the more stringent net capital requirements of Exchange Rule 325, promul-

(Footnote continued on next page)

has been described as the "principal regulatory tool" used by the SEC to monitor the financial soundness of brokers and dealers. Press Release, January 10, 1973 [1972-73 Transfer Binder] FED. SEC. L. REP. (CCH), ¶ 78,174 at 82,578. As the SEC has stated:

> "The principal purpose of the [net capital] rule is to require that the capital position of a broker or dealer will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers." Exchange Act Release No. 8024 [1967] 5 FED. SEC. L. REP. (CCH) ¶ 72,129 (subsequently rescinded and omitted).

More recently, the SEC announced certain amendments to the net capital rule and reiterated its essential purpose, as follows:

> "[T]he amount of the firm's liquid assets in excess of the broker's or dealer's minimum requirement necessary to protect customers gives the [SEC], self-regulators and SIPC sufficient early warning to take appropriate action to protect customers prior to the time when the broker's or dealer's assets would be insufficient to satisfy customers claims in the event of liquidation." Exchange Act Release No. 11497 [1975-76 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,212.

Of course, the net capital rule effectuates congressional policy, for as is noted in the legislative history underlying the enactment of SIPA:

(Footnote continued from preceding page)
gated by the Exchange pursuant to Section 6(d) of the 1934 Act. Accordingly, Weis was not permitted to allow its "aggregate indebtedness" to exceed 1500% of its "net capital" as those terms are defined in Exchange Rule 325. (The SEC's rule required a less stringent 20 to 1 ratio.)

> "Congress did not intend to permit a broker to continue operations unless he had on hand cash or liquid assets in the required ratio to aggregate indebtedness." H.R. REP. No. 91-1613, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5254, 5266.

As previously explained, the very means for determining and enforcing net capital compliance are rooted in Section 17(a). Rule 17a-5 promulgated under the section required the filing of Form X-17A-5 which was "designed to reflect the financial condition of the reporting broker and dealer; and, accordingly, it contains details calculated to reveal whether or not the broker-dealer is in compliance with, among other things, applicable 'net capital' requirements." [10]

Accordingly, as the Court of Appeals here recognized:

> "It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows." (A. 198).

D. *The Accountants' Role And Duty With Respect To The Section 17(a) Filings*

While Weis' Section 17(a) reports were filed with the SEC and with the Exchange, neither of these organizations

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[10] REPORT AND RECOMMENDATIONS OF THE SECURITIES AND EXCHANGE COMMISSION, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, H.R. Doc. No. 92-231, 92d Cong., 2d Sess. 24 (1971). This report was made pursuant to Section 11 of SIPA, which directed the SEC to report to Congress concerning unsound broker-dealer practices and to make recommendations for their elimination.

verified, nor were they expected to verify, the information contained in the reports. Instead, both the SEC and the Exchange relied on the Touche Ross certifications as to the accuracy of these reports, and thus were misled as to Weis' compliance with the net capital rule.

As in effect in 1972 when Touche Ross facilitated the massive deception caused by Weis' Section 17(a) reports, Rule 17a-5 required that:

— the report to be filed by the broker-dealer "be certified by a certified public accountant or a public accountant who shall be in fact independent" [Rule 17a-5(b)(1)];[11]

— the accountant's certificate contain, *inter alia*, "a reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers" [Rule 17a-5(g)(2)];

— the accountant's certificate "state clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein" [Rule 17a-5(h)]; and

— "[a]ny matters to which the accountant takes exception shall be clearly identified . . . specifically and clearly stated . . . [and] the effect of each such exception on the related item of the report shall be given" [Rule 17a-5(i)].

[11] Significantly, an accountant's certificate was not required if the broker-dealer's business was such as would not expose customer cash or securities to the risk of loss. See proviso in Rule 17a-5(b)(1).

Even more importantly, Form X-17A-5 required that:

"AUDIT REQUIREMENTS

The audit shall be made in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding securities including appropriate tests thereof for the period since the prior examination date. It shall include all procedures necessary under the circumstances to substantiate the assets and liabilities and securities and commodities positions as of the date of the responses to the financial questionnaire and to permit the expression of an opinion by the independent public accountant as to the financial condition of the respondent at that date. Based upon such audit, the accountant shall comment upon any material inadequacies found to exist in the accounting system, the internal accounting control and procedures for safeguarding securities, and shall indicate any corrective action taken or proposed. These comments may be submitted in a supplementary certificate and filed pursuant to Rule 17a-5(*b*) (2). . . ." (emphasis added).

This was followed by a comprehensive list of the procedures to be conducted by the auditor, and concluded with:

"NOTE: PROVISIONS OF RULE 17a-5 REQUIRE THAT THE REPORTS OF CERTAIN BROKERS AND DEALERS BE AUDITED BY A CERTIFIED PUBLIC ACCOUNTANT OR PUBLIC ACCOUNTANT WHO SHALL BE IN FACT INDEPENDENT. WITH RESPECT TO QUALIFICATIONS OF ACCOUNTANTS, ACCOUNTANT'S CERTIFICATE, OPINIONS TO BE EXPRESSED, AND EXCEPTIONS, PLEASE REFER TO RULE 17a-5." (as printed in original).

In view of the foregoing explicit requirements in Rule 17a-5 and Form X-17A-5, it can hardly be doubted that

specific and crucial obligations were imposed upon accountants pursuant to Section 17(a).[12]

It is also important to note that Congress considered, but ultimately rejected, requiring the government itself to audit SEC filings. Instead, Congress chose to have such filings audited by independent public accountants. *See,* SEC Accounting Series Release No. 81 [1958] 5 FED. SEC. L. REP. (CCH) ¶72,103.[13]

Moreover, among the early amendments to Rule 17a-5[14] was a broadening of the certification requirements, which occasioned the following statement in the SEC News Digest for August 8, 1957 (at 3):

> "[The amendment] . . . adds another important protective feature to the . . . [SEC's] continuing program for improving the safeguards afforded to customers of broker-dealer firms. . . . *The . . . [SEC] believes that it is essential, for the protection of public investors, that the accounts of these broker-dealers who do business with the investing public and handle customers' funds and securities be subject to an annual audit by an independent accountant.*" (emphasis added).

[12] As to Touche Ross' novel contention that it was not subject to a duty under Section 17(a) because the obligations imposed upon it emanated from Rule 17a-5, and not from the statute, see pp. 30-31, *infra.*

[13] *See also* Sonde, *The Responsibility of Professionals Under the Federal Securities Laws—Some Observations,* 68 NW. U.L. REV. 1, 2 (1973) ("Although it was initially proposed that the Government hire a corps of auditors to perform the audit responsibility for financial statements filed with the [SEC], it was decided that such statements be audited by independent public accountants. This decision was based upon the accounting profession's representation that it was willing and able to assume this responsibility.")

[14] Adoption of the amendment to Rule 17a-5(b)(1) was announced in Exchange Act Release No. 5560 [1957-61 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 76,532.

Indeed, the accounting profession itself has recognized that accountants bear a responsibility not only to the brokers who hire them, but especially to the brokers' customers and the regulatory authorities who rely on their certifications as to the brokers' financial soundness:

> "The forms of financial reporting of broker-dealers, in accordance with requirements established by the regulatory or self-regulatory bodies, are intended to meet the needs of customers who do business with the securities concerns, the regulatory bodies and, in the case of firms with public ownership, the needs of stockholders." AICPA, AUDIT OF BROKERS AND DEALERS IN SECURITIES xi (1977).[15]

In fact, a Touche Ross partner who worked on the very 1972 Weis audit which underlies this action has written that:

> "[I]t is our responsibility to determine when financial statements do not present fairly the financial position of a company. Therefore, if a fraud is so pervasive as to destroy the very fabric of the financial statements we audit, we must strive to detect this condition. We may not always be successful, but we cannot afford to fall back on the thinking that collusive actions always defeat internal controls and circumvent audit techniques. *This negativism would stultify all efforts to discover such problems and thus be abandonment of duty.* Therefore, I believe that the performance gap between public (here, the SEC) expectations and reality can be narrowed." Weinstein, *A Time of Travail*

[15] *See also In re Touche, Niven, Bailey & Smart,* Accounting Series Release No. 78 [1957] 5 FED. SEC. L. REP. (CCH) ¶ 72,100 at 62,212.

and Challenge, 44 C.P.A. J. 29 (Dec. 1974) (emphasis added).[16]

The rules and forms promulgated under Section 17(a) constitute an "early warning system" which is designed to detect the financial unsoundness of broker-dealers at the earliest possible moment. Accountants play the pivotal role in that system and their certifications of Section 17(a) reports are the *only* means through which the SEC and the self-regulatory organizations are assured that broker-dealers are not in violation of the net capital rule. It is against this background that the Court of Appeals here held that Section 17(a) imposes a duty upon accountants. (A. 195-96).

E. *The Opinions Below*

The District Court (Wyatt, J.) dismissed the complaint, holding that Section 17(a) does not create any rights of action in anybody (A. 177). The Court of Appeals reversed, holding that (1) brokers' customers have a right of action under Section 17(a) against accountants (A. 201); (2) that SIPC may assert that right of action as the customers' subrogee (A. 201); and (3) that the Trustee, as the bailee of Weis' customers' property, may assert that right of action on behalf of those customers who have not been fully reimbursed by SIPC.[17]

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[16] In its answers to plaintiffs' preliminary interrogatories in this action, Touche Ross listed Mr. Weinstein as one of its partners who had worked on the 1972 Weis audit.

[17] In a footnote, the Court of Appeals also stated that "[it] need not reach the question whether SIPC could ever have a claim for damages other than on behalf of broker's customers," and went on to express doubt as to SIPC's right to assert a Section 17(a) right of action in its own behalf (A. 201 n.13). This aspect of the Court of Appeals decision is addressed in SIPC's conditional cross-petition for certiorari (No. 78-526), which is still *sub judice.*

Summary Of Argument

I

A. The assertion of a private right of action herein is rooted in the longstanding principle that the members of a class for whose protection a statute was enacted have a right of action for its breach, particularly where the remedy also serves to vindicate and effectuate the congressional purpose underlying the statute. Applying the traditional "statutory tort" doctrine as it has evolved in modern decisional law on implied rights of action, it is clear that all the requisite elements for a legally cognizable claim for relief are present in this case. Thus, Weis' customers are the very persons Congress sought to protect under Section 17(a); Touche Ross has breached its duty to such persons under Section 17(a) to their damage; there is no indication of congressional intent to deny such a private right of action; and a federal right of action is necessary and appropriate to further the congressional purpose of safeguarding customers' securities and cash entrusted to broker-dealers.

B. Touche Ross shuns an analysis of the relevant factors to be considered in this case, as summarized by this Court in *Cort* v. *Ash,* 422 U.S. 66 (1975), and instead makes the specious argument that enactment of Section 18(a) of the 1934 Act indicates an explicit congressional intention to deny private rights of action to customers under Section 17(a). This argument ignores the obvious fact that the two sections are clearly intended to deal with investors in different capacities, and seek to protect against two distinct types of wrongs. The purpose of

enacting Section 17(a) was to protect investors in their capacity as customers entrusting securities or cash to their broker-dealers. Under this section, an elaborate system was structured involving certification of brokers' financial conditions by independent auditors in order that the regulatory bodies would learn promptly of brokers' financial difficulties. On the other hand, Section 18(a) was enacted for the benefit of investors in their capacity as purchasers or sellers of securities who are injured by reason of their justifiable reliance on false statements filed by corporate issuers. Thus, analysis of the purpose and function of each of the sections establishes that Section 18(a) does not deal with or reach the intended beneficiaries of Section 17(a) or the wrongs that section seeks to forestall.

It is clear that Section 18(a), which is limited to actions based on the purchase or sale of securities, was not intended to, and indeed does not, provide a remedy for a violation of Section 17(a), which deals with reports filed by broker-dealers.

Touche Ross and the dissent below conclude, not merely that Section 18(a) covers violations of Section 17(a), but that "section 18(a) expressly provides the *sole private remedy* which Congress *intended* to be available for a violation of Section 17(a). . . ." (A. 211) (emphasis added). There is no support for this conclusion in the legislative history of either section; indeed, the contrary is indicated.

C. There is also nothing in the cases cited by Touche Ross as "controlling" which suggests that a private right of action should not be implied herein. In *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("Amtrak"), and *SIPC* v. *Barbour*, 421 U.S. 412 (1975), the Court declined to imply

a private right to sue to enforce the particular Act because it found clear legislative intent to deny such a right and because it concluded that the implication of such a right would be inconsistent with the effectuation of the purpose of the Act.

In this case implication of a private right of action would be consistent with the underlying purposes of the 1934 Act and, indeed, is necessary in order to effectuate the purposes of Section 17(a). Such a private remedy would constitute a necessary supplement to SEC action and would act as a deterrent against further abuses.

II

D. SIPC was required to, and did, advance funds to the Trustee for the satisfaction of customers' claims made against the Weis estate. Thus, under the fundamental common law doctrine of equitable subrogation, SIPC is subrogated to the rights Weis' customers could have asserted against Touche Ross, the wrongdoer, had their claims not been satisfied by the funds advanced to the Trustee by SIPC.

E. Nothing in SIPA or in its legislative history suggests that Congress intended SIPC's statutory subrogation right to customers' claims against the broker's estate to be SIPC's exclusive subrogation remedy. In fact, it appears that Congress intended just the opposite. Indeed, Congress incorporated SIPA into the 1934 Act which expressly provides that common law rights and remedies are to be preserved.

Moreover, the statutory subrogation right in SIPA appears in the context of a detailed blueprint for the

distribution of a liquidated debtor's estate. There is no such comprehensive scheme in SIPA as to rights *outside* a liquidation proceeding, and thus there was no need to define SIPC's common law subrogation right.

Congress' generally expressed policy was to maximize SIPC's recovery of the funds it expends in the course of broker-dealer liquidations. Certainly, SIPA was not enacted so as to shift liability from wrongdoers, such as Touche Ross, to SIPC. Finally, considerations of public policy require that SIPC's common law subrogation rights be preserved.

ARGUMENT

I

The Court Of Appeals Correctly Held That, As The "Favored Wards" Of Section 17(a) Of The 1934 Act, Customers Of A Stockbrokerage Firm Have A Right Of Action Under That Section Against The Firm's Accountants Who Breach The Duty Imposed Upon Them By The Section

The holding by the Court of Appeals adheres to—indeed, is mandated by—the longstanding principle that the members of a class for whose protection a statute was enacted have a right of action for its breach, especially where the remedy also serves to vindicate and effectuate the congressional purpose underlying the statute.

As the Court of Appeals recognized: Weis' customers are none other than the very persons Congress sought to protect under Section 17(a); SIPC, as their subrogee, is

seeking to vindicate the very purpose which underlies the section, viz., the safeguarding of customers' cash and securities entrusted to broker-dealers; and a federal right of action under Section 17(a) is necessary and appropriate to further that congressional purpose.

In an attempt to obfuscate the application of the considerations relevant to the issue before this Court, Touche Ross has studiously avoided any meaningful discussion or analysis of the implied rights doctrine. Instead, it seizes upon Section 18(a) of the 1934 Act—which in no way addresses the concerns of Section 17(a) or its purposes—and proceeds to build a convoluted and lengthy argument upon the faulty premise that the two sections are closely related. As a result of this and other serious flaws, including a disjointed treatment of the relevant decisions of this Court, Touche Ross' discussion and analysis of the questions presented are neither analytical nor illuminating.

A. *The Existence Of Section 18(a) Is Not A Material Consideration To The Issue Before This Court*

Despite the length of its brief, Touche Ross fails to analyze Section 17(a) in terms of its particular purpose and place in the overall statutory scheme. The purpose of the 1934 Act is to protect investors in their three basic spheres—as purchasers and sellers of corporate securities (the transactional sphere); as customers of brokers and dealers (the bailment sphere); and as shareholders in direct relationship with their corporations (the corporate relationship sphere). Sections 8, 15 and 17(a) deal with, and offer protection to, investors in the bailment sphere. Other sections, such as 10(b) and 18, are addressed to, and protect, investors in the transactional sphere. Yet other sections, such as 14(a), protect investors in the corporate relationship sphere.

The essential flaw in Touche Ross' entire approach to the issue presented herein is its refusal to appreciate—or acknowledge—the basic distinctions within the statutory scheme as to the capacity in which an investor is sought to be protected, and as to the means of protection sought to be afforded. Consequently, Touche Ross' premises regarding "the statutory scheme of the 1934 Act" and its exclusive focus on the existence of Section 18(a), are faulty.

Section 18(a) simply does not deal with or reach the intended beneficiaries of Section 17(a) or the wrongs which it seeks to forestall. Therefore one cannot conclude, as does Touche Ross and the dissent below, "that Section 18(a) expressly provides the sole private remedy which Congress intended to be available for a violation of Section 17(a). . . ." (A. 211).

B. *The Historical Development Of The Doctrine Of Implied Rights Of Action And The Relevant Factors To Be Considered*

That the federal courts may imply private remedies from federal statutes is a longstanding doctrine, originating in English jurisprudence and based upon the common law tort principle that the violation of a statute makes the actor liable to another person if the intent of the statute is to protect that person from the particular harm caused.[18] See RESTATEMENT OF TORTS § 286 (1934).[19]

[18] "[I]n every case, where a statute enacts or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage or for the recompence of a wrong done to him contrary to the said law." I Comyn's Digest 248 (1762), quoted in *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33, 39 (1916).

[19] The most recent draft of the Restatement of Torts provides that "in furtherance of the purpose of particular legislation" a court may "supply a civil action for damages affording relief to a

(Footnote continued on next page)

This "statutory tort" doctrine was enunciated by this Court in *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U.S. 33, 39 (1916). In holding that a railroad switchman could recover from his employer for injuries resulting from a violation of federal railroad safety legislation, this Court stated:

> "A disregard of the command of the statute is a wrongful act, and where it results in damages to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is *implied*. . . ." (emphasis added).

Relying on the Restatement of Torts and this Court's teaching in *Rigsby*, the district court in *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), first applied this doctrine to the federal securities laws, ruling that shareholders who were induced to sell their stock by fraudulent misrepresentation could recover under Section 10(b) of the 1934 Act and Rule 10b-5.[20] Three years later, the court in *Hawkins* v. *Merrill Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949), in reliance upon *Kardon*, recognized a private right of action under Section 17(a) and Rule 17a-5—the very provisions at issue in this case.[21]

(Footnote continued from preceding page)

person for whose benefit conduct of another was either proscribed or required by the legislation." RESTATEMENT (SECOND) OF TORTS § 874A (Tent. Draft No. 22, 1976).

[20] This Court has repeatedly confirmed the existence of a private right of action under Section 10(b) and Rule 10b-5. *See, e.g., Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477 (1977); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); and *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

[21] Touche Ross incorrectly states that "[i]n the 45 years since enactment of the 1934 Act . . . [not] a single court . . . [found] it appropriate—let alone 'necessary'—to imply a private right of action for damages under Section 17(a)." Petitioner's Brief at 63.

More recently, in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), this Court unanimously held that an implied cause of action for damages existed in favor of shareholders of a corporation under Section 14(a) of the 1934 Act for deceptive proxy solicitations in violation of that provision.[22] Subsequently, in *Wyandotte Transportation Co.* v. *United States*, 389 U.S. 191 (1967), a unanimous court reaffirmed the basis of the *Rigsby* and *Borak* decisions as follows:

> "Because the interest of the plaintiffs in those cases fell within the class the statute was intended to protect, and because the harm that had occurred was of the type that the statute was intended to forestall, we held that civil actions were proper. That conclusion was in accordance with a general rule of the law of torts. See Restatement (Second) of Torts, § 286." *Id.* at 202.

In 1974 this Court was faced with a situation wherein an implied private right of action was being urged despite the fact that (a) there was clear legislative intent to deny such a right, and (b) the implication of such a right would subvert the underlying purposes of the statute. Thus, in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("Amtrak"), this Court noted that:

> "the inference of . . . a private cause of action not otherwise authorized by the statute must be consistent with the evident legislative intent and, of course, with the effectuation of the purposes intended to be served by the Act." *Id.* at 458.

The following Term, in *SIPC* v. *Barbour*, 421 U.S. 412, 418 (1975), this Court reaffirmed the relevance of the above-quoted considerations in determining the propriety of implying a private right of action.

[22] *See also Mills* v. *Electric Auto-Lite*, 396 U.S. 375 (1970).

Subsequently, in *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), this Court harmonized the considerations applied in *Amtrak* and *Barbour* with the earlier statutory tort test and synthesized the factors to be examined in determining whether a private right of action should be implied under a particular statute.[23]

In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), this Court's most recent decision addressing the assertion of an implied right of action under the 1934 Act, the Court reaffirmed the relevance and utility of the *Cort* v. *Ash* analysis.

C. *Cort v. Ash Provides A Useful Framework For Considering Whether A Private Right Of Action Should Be Implied Under Section 17(a)*

Cort v. *Ash*, with its recitation and analysis of the relevant considerations, provides a useful framework for considering the issue presented herein.

Citing *Rigsby*, the *Cort* analysis begins with the primary consideration of whether the plaintiff is a member of a class for whose special benefit the statute was enacted, "that is, does the statute create a federal right in favor of the plaintiff?" 422 U.S. at 78. It then determines whether a traditional remedy for the violation of that right should be withheld by considering particular legislative intent, overall statutory purpose and scheme, and questions of federalism.

Seizing upon a particular phrase in the *Cort* opinion,[24] Touche Ross argues that in Section 18(a) a private remedy for violation of Section 17(a) is expressly provided

[23] The four factors in *Cort* v. *Ash* are set forth *infra* at 26-27.

[24] "In determining whether a private remedy is implicit in a statute *not expressly providing one*, several factors are relevant." 422 U.S. at 78 (emphasis added).

for and therefore *Cort* "does not set forth the appropriate analysis here." Petitioner's Brief at 40. Touche Ross then concludes that the appropriate analysis is set forth in *Amtrak, Barbour* and *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). *Id.* As will be demonstrated, *infra* at 33-34, 36, because Section 18(a) does not address or enter the sphere in which Section 17(a) was meant to operate, it cannot be said to extinguish traditional remedies provided to the intended beneficiaries of Section 17(a). It will be seen that Touche Ross' "argument" as to the inappropriateness of an analysis under *Cort* cannot stand.

Finally, as will also be demonstrated, *infra* at 37-42, not only are *Amtrak, Barbour* and *Blue Chip* entirely beside the mark as controlling cases, there is nothing in or about those decisions which compels or even suggests the conclusion that a private right of action should not be implied under Section 17(a).

D. *Consideration Of The Relevant Factors Compels The Conclusion That A Private Right Of Action Should Be Implied In Favor Of Brokers' Customers*

The factors to be considered were summarized in *Cort* as follows:

> "In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted,' *Texas & Pacific R. Co.* v. *Rigsby,* 241 U.S. 33, 39 (1916) (emphasis supplied)—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? See, *e.g., National Railroad Passenger Corp.* v. *National Ass'n. of Railroad Passengers,* 414 U.S. 453, 458, 460 (1974) (*Amtrak*). Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? See, *e.g., Amtrak, supra; Securities Investors Protection Corp.* v. *Barbour,* 421 U.S. 412, 423 (1975); *Calhoon* v. *Harvey,* 379 U.S. 134 (1964). And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law? See *Wheeldin* v. *Wheeler,* 373 U.S. 647, 652 (1963); cf. *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 434 (1964); *Bivens* v. *Six Unknown Federal Narcotics Agents,* 403 U.S. 388, 394-395 (1971); id., at 400 (Harlan, J., concurring in judgment)." 422 U.S. at 78.

An application of these factors to the instant case indicates the propriety of implying a private right of action under Section 17(a) in favor of brokers' customers.

1. *Brokers' Customers Are The Special And Intended Beneficiaries Of Section 17(a) And The Duties Imposed Thereunder*

The first inquiry in *Cort* is whether the plaintiff is " 'one of the class for whose *especial* benefit the statute was enacted' . . . that is, does the statute create a federal right in favor of the plaintiff?" 422 U.S. at 78. The inquiry is really a formulation of the principal element of the classic statutory tort doctrine. The other element is a breach of duty to the damage of the intended beneficiary of the statute. (The legal duty owed by Touche Ross will be discussed *infra* at 30-31.)

As is apparent, this first consideration is more than a relevant factor—it is the threshold determination from

which the remedy flows unless the court concludes it must be denied by reason of the other three considerations.

That customers of brokers are the intended beneficiaries of Section 17(a) cannot be denied. In the words of the Court of Appeals, "[t]he language of section 17, the SEC rules in the 17a-5 series, and an analysis of the role played by accountants' reports in the regulation of brokers make clear the extent to which Weis' customers are members of a class peculiarly protected by section 17." (A. 196).

As in effect in 1972, Section 17(a) required a broker-dealer such as Weis to "make such reports, as the [Securities and Exchange] Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for *the protection of investors.*" (emphasis added).[25]

Pursuant to this provision, the SEC adopted Rule 17a-5, requiring broker-dealers to submit certain reports of their financial condition to the SEC at least annually on a Form X-17A-5. The form contains a detailed financial questionnaire as to, *inter alia,* customers' security accounts, the broker's trading, investment, and subordinated accounts, and the broker's "net capital." Like Section 17(a) itself, the rule promulgated and the form required thereunder were devised to protect customers against the hazards of entrusting their securities to broker-dealers. Prior to the adoption of Rule 17a-5, the SEC emphasized that adoption of the rule would increase customers' protection against the risk involved in leaving their securities with broker-dealers.

[25] In *Borak* this Court explained the propriety of finding an implied right of action under Section 14(a) as follows:

> "While . . . [14a] makes no specific reference to a private right of action, among its chief purposes is 'the protection of investors' which certainly implies the availability of judicial relief where necessary to achieve that result." 377 U.S. at 432.

National Association of Securities Dealers, 12 S.E.C. 322, 339 n.9 (1942). Similarly, in 1957, when the SEC expanded the certification requirements for Section 17(a) reports, it reiterated that the "certification and reporting requirements constituted a valuable regulatory tool *for the protection of a customer in respect of the risks involved in leaving his money and securities with his broker-dealer.*" REPORT AND RECOMMENDATIONS OF THE SECURITIES AND EXCHANGE COMMISSION, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS, H.R. Doc. No. 92-231, 92d Cong., 2d Sess. 24 (1971) (emphasis added, footnote omitted).[26]

As noted earlier,[27] the accounting profession itself has recognized that the customers of broker-dealers are the class intended to be protected by the Section 17(a) reports.

Unquestionably, the function of the various financial reports required to be prepared and certified by independent accountants[28] and filed with the SEC is to protect customers against losses which may be incurred by reason of a broker's insolvency.[29]

As noted by the Court of Appeals:

> "The function of this arsenal of financial reports [required under Rule 17a-5] is to protect the broker's customers. One of the main methods adopted by the SEC to shield customers is the net capital rule . . . .

[26] This subject is discussed more fully at pp. 8-11 *supra.*

[27] See p. 15 *supra.*

[28] The question raised by Touche Ross as to accountants' duties under Section 17(a) is discussed *infra* at 30-31.

[29] As the SEC has noted, "[c]ustomers do not open accounts with a broker relying on suit, judgment and execution to collect their claim—they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position." *Guy D. Marianette,* 11 S.E.C. 967, 970-71 (1942).

> "The . . . 'principal purpose . . . [of the net capital rule] is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers.' Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,129 (1967) . . . .
>
> "It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows." (A. 197-98).

It is undeniable then that customers of brokers are "the class for whose especial benefit [Section 17(a)] was enacted . . . ."—the "favored wards" of Section 17(a) in the words of the Court of Appeals. (A. 200). Touche Ross does not contend otherwise.

As noted earlier, *supra* at 11-16, in light of the explicit requirements of Rule 17a-5 and Form X-17A-5, and the pivotal role accountants play in the statutory scheme, there can be no question that Touche Ross owed a duty to Weis' customers under Section 17(a).

Yet, Touche Ross raises the novel contention here that it was not subject to any duty under Section 17(a) because only the rule thereunder, and not the statute itself, refers to accountants. Petitioner's Brief at 79-80.[30] Apparently,

[30] Touche Ross misplaces its reliance upon *Rothstein* v. *Seidman & Seidman*, 410 F. Supp. 244 (S.D.N.Y. 1976) and *In re Equity Funding Corp. of America Securities Litigation*, 416 F. Supp. 161 (C.D. Cal. 1976). In each of those cases the rule upon which the action was predicated made no mention whatsoever of accountants. Of course, the same can hardly be said about Rule 17a-5 here. Similarly, Touche Ross' reference to *Santa Fe Industries, Inc.* v.

(Footnote continued on next page)

Touche Ross has overlooked that, on numerous occasions and with respect to various statutes, this Court has held that rules properly promulgated by a government agency pursuant to a congressional enabling mandate "have the force of law." *See, e.g., Public Utilities Commission of California* v. *United States*, 355 U.S. 534, 542 (1958); *Standard Oil Co.* v. *Johnson*, 316 U.S. 481, 484 (1942). Such rules "supplement the statute" under which they were promulgated. *Accardi* v. *Shaughnessy*, 347 U.S. 260, 265 (1954). Indeed, as this Court noted specifically with respect to rules under the 1934 Act, such rules may provide "the basis for imposition of liability." *General Electric Co.* v. *Gilbert*, 429 U.S. 125, 141 (1976). In fact, Section 27 of the 1934 Act grants exclusive jurisdiction to the federal courts as to "*violations* of this title or *the rules and regulations thereunder*," and as to "all suits in equity and actions at law *brought to enforce any liability or duty created by* this title or *the rules and regulations thereunder* (emphasis added).

Accordingly, Touche Ross may not escape the duty imposed upon it by Section 17(a) and Rule 17a-5 thereunder and owed to the intended beneficiaries thereof.

(Footnote continued from preceding page)

Green, 430 U.S. 462 (1977), and *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), for the proposition that a statute controls the interpretation of a rule, and that the scope of the latter may not exceed the power granted by the former, is wholly inapposite here. Both *Santa Fe* and *Hochfelder* involved the question of whether a lower standard for liability may be imposed under a rule than would be available under the enabling statute. Rule 17a-5 does not broaden the standard of liability under Section 17(a); in fact, neither the section nor the rule refers to standards for liability. Rather, the rule merely effectuates the section's mandate, and is consistent with its purpose; and not even Touche Ross argues that, in promulgating the rule, the SEC exceeded the power congressionally delegated to it by the section.

2. *There Is No Indication That Congress Explicitly Considered Whether To Create Or Deny A Private Right Of Action Under Section 17(a) Or That Congress Implicitly Chose To Deny A Private Right Of Action*

Cort next inquires: "[I]s there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one?" 422 U.S. at 78. As to this factor *Cort* noted:

> "[I]n situations in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling." *Cort* v. *Ash,* 422 U.S. at 82 (footnote omitted).

The Court of Appeals found no indication, either in the statute itself or its legislative history, of any congressional intent to create or deny a private right of action under Section 17(a). The Court further concluded that there was no indication that Congress implicitly chose to deny a private right of action. (A. 198).

Touche Ross argues, however, that a congressional intent to deny a private right of action to customers under Section 17(a) is found in the enactment of Section 18(a).

(a) *Nothing In Section 18(a) Or In Section 17(a), Or In The Legislative History Of Either Section, Or In The Overall Legislative Scheme Suggests That Congress Intended Section 18(a) To Be The Exclusive Remedy For Any Violations Of Section 17(a)*

Section 17(a) only covers reports and documents filed by broker-dealers, the financial security of which is important to their customers who have securities or cash on deposit with them. As demonstrated, pp. 21, 27-30 *supra,* the purpose of enacting Section 17(a) was the protection of investors in their capacity as customers. Section 18(a) on the other hand was enacted for the benefit of investors in their capacity as purchasers or sellers of securities, who are injured by reason of their reliance on false statements filed by corporate issuers under certain reporting sections such as 13(a) or 15(d).

Even in those situations where a broker is also an issuer, the possibility of a violation of Section 17(a) being covered by Section 18(a) is merely theoretical.[31] The documents upon which investors make investment decisions are such things as prospectuses or registration statements, and not Section 17(a) documents. A situation in which an investor purchased or sold stock of a broker-issuer in reliance upon false statements in a report filed pursuant to Section 17(a), at a price "affected by" that misstatement, is, if not wholly theoretical, surely aberrational.

Yet it is on this slender reed, this theoretical possibility, that Touche Ross and the dissent conclude that "section 18(a) expressly provides the *sole private remedy* which

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[31] Section 18(a) provides, in relevant part, that any person filing a false or misleading statement "shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement. . . ."

Congress intended to be available for a violation of Section 17(a). . . ." (A. 211) (emphasis added). No support for this proposition can be found in the legislative history of Section 17(a) or 18(a).

Significantly, the legislative history of Section 18(a) is barren of any reference to liability for the false and misleading reports of broker-dealers filed pursuant to Section 17(a).[32] However, Touche Ross makes the bold assertion that "the legislative history does reflect a congressional *understanding* that the express Section 18(a) remedy was to apply to misstatements in Section 17(a) reports. . . ." Petitioner's Brief at 47 (emphasis added). The sole "authority" for this conclusion is a statement by the President of the New York Stock Exchange submitted to the Senate and House committee considering the bill. *See* Petitioner's Brief at 37 n.18.

Putting aside the ambiguous nature of the passing reference to "persons transacting business in securities" in the statement itself, it is absurd to conclude that a statement submitted to Congress by a third party establishes Congress' understanding of legislation eventually enacted by it. As recently as in *Piper* this Court, questioning "the value of written statements received without comment by the committee and without cross-examination," stated:

> "Only last Term we indicated that similar materials in the legislative history of the 1934 Act were of limited value.
>
> 'Remarks of this kind made in the course of legislative debate or hearings other than by persons responsible for the preparation or the drafting of a bill are entitled to little weight.' *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 204 n.24 (1976)." 430 U.S. at 31 n.20.[33]

[32] The legislative discussion excerpted in the *amicus curiae* brief of the American Institute of Certified Public Accountants at 9-10 is singularly unilluminating. The context of that discussion was whether experts, as opposed to other persons, could be held liable under Section 18, and not whether Section 18 applied to broker-dealers' Section 17 reports.

In fact, the legislative history of Section 18(a) reflects that the concern underlying that section was not with *all* false or misleading reports, but only with such reports as are filed by *corporations,* that is, with reports which potentially could affect the price of a corporation's securities. (At the time, only individuals—not corporations—could be members of the Exchange.[34] Quite obviously, therefore, the concern expressed for corporations did not include broker-dealers.) The Senate Report, in an obvious reference to Section 18, states that it

> "provides that any person who unlawfully manipulates the price of a security, or who induced transactions in a security by means of false or misleading statements, or who makes a false or misleading statement in the report *of a corporation,* shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement." S. REP. No. 792, 73d Cong., 2d Sess. 13 (1934) (emphasis added).[35]

[33] To the extent that such statements are given any weight, the fact is that numerous such statements indicate that their authors did not regard Section 18 as covering statements by brokers. *See* note 35 *infra.*

[34] *See* C. Meyer, THE LAW OF STOCKBROKERS AND STOCK EXCHANGES 86 (1931).

[35] During the hearings, wherever the type of report covered by Section 18 was clearly identified, it was invariably identified as a report about "corporations." *Hearings Before the Senate Banking and Currency Committee on S. Res. 56 and S. Res. 97,* 73d Cong., 1st Sess. 6673, 6697, 7186, 7281, 7282 (1934).

Thus the legislative history of Section 18(a) does not provide any basis for concluding that Congress even considered that section's relationship to Section 17(a), much less that it intended Section 18(a) to have a preclusive effect upon Section 17(a) and thereby to deny a remedy to the very class of investors it sought to protect by Section 17(a).

As noted *supra* at 33, Sections 17(a) and 18(a) are addressed to and deal with investors in two different and distinct capacities or spheres. Moreover, the sections are designed to deal with or protect against two distinct types of wrongs. The customers of a broker are wronged when they lose their securities or cash by reason of having continued to entrust same to the broker who, despite serious financial reverses, continues in business for a period on the basis of certified, but false, Section 17(a) reports. On the other hand, purchasers or sellers of securities are wronged when they have been misled by the issuer's false or misleading reports or statements and, in reliance thereon, purchase or sell the issuer's security at a price affected by the false statement.

In view of the foregoing considerations—no legislative history suggesting a connection between Sections 17(a) and 18(a), distinct categories of investors intended to be protected, and separate wrongs intended to be prevented—the Court of Appeals correctly rejected Touche Ross' contention that Section 18(a) precludes the recognition of a right of action under Section 17(a). As the Court of Appeals stated:

> "Since any misstatement in a section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customers, a strict application of section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of section 17. *We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection.*" (A. 200) (emphasis added).

(b) *Nothing In Amtrak Or Barbour Suggests That A Private Right Of Action Should Not Be Implied Here*

As noted above, *Amtrak* and *Barbour* held that implication of a private right of action "must be consistent with the evident legislative intent and, of course, with the effectuation of the purposes intended to be served by the Act." 414 U.S. at 458; 421 U.S. at 418.

In each case the issue was whether a private right of action to sue to enforce provisions of an act could be implied where Congress had enacted a provision in the act specifically granting such right to a person other than plaintiff. In each case this Court found "evident legislative intent" to deny a private right of action, and also found that to imply such a right would be inconsistent with the effectuation of the purposes intended to be served by the Act.[36]

In *Amtrak* the issue was whether the Rail Passenger Service Act ("Amtrak Act") could be read to create a private right of action on behalf of railroad passengers to enforce compliance with the Act's provisions. The Act's single section authorizing suits to enforce duties and obligations, Section 307(a), specifically provided for a public cause of action to vindicate private rights, maintainable by the Attorney General, and a *private* cause of action "*explicitly limited* to 'a case involving a labor agreement.'" 414 U.S. at 457 (emphasis added). Not only did the Act contain

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[36] This latter consideration is the third of the four factors listed in *Cort* and will be discussed *infra* at 42.

an express remedy for the specific wrong sought to be addressed, *i.e.*, a private right of action to sue for enforcement, the legislative history indicated that Congress had actually considered and rejected allowing a broader class of private plaintiffs. *Id.* at 458-61. This Court thus concluded that "the legislators understood that § 307(a) as written would preclude private causes of action to enforce compliance with the Act, other than in the limited area of cases 'involving a labor agreement.'" *Id.* at 461. The Court also concluded that implying a private right of action in favor of passengers affected by the discontinuance of passenger trains would "completely undercut the efficient apparatus that Congress sought to provide for Amtrak to use in the 'paring of uneconomic routes.'" *Id.* at 463.[37]

Barbour presented a similar situation. The issue presented therein was whether customers of broker-dealers have an implied private right of action under SIPA to compel SIPC to discharge its obligations under the Act. SIPA contained a provision granting *to the SEC* the right to sue to compel SIPC to discharge its obligations under the Act.

[37] As the Court explained the situation:

"In § 404 of the Act, Congress provided an efficient means whereby Amtrak could eliminate uneconomic routes . . . without the necessity of submitting to the time-consuming proceedings of state regulatory bodies or the Interstate Commerce Commission that had been required before the Act's passage. If, however, § 307(a) were to be interpreted as permitting private lawsuits to prevent the discontinuance of passenger trains, then the only effect of the Act in this regard would have been to substitute the federal district courts for the state or federal administrative bodies formerly required to pass upon proposed discontinuances." 414 U.S. at 461-62 (footnotes omitted)

The Court went on to discuss the inordinate delays and dislocations that would result from multiple suits in the various district courts around the country. *Id.* at 463-64.

421 U.S. at 417-18. This Court's holding that no private right of enforcement could be implied was based on its analysis of the legislative intent and overall legislative scheme from which it concluded that "a private right of action under the SIPA would be consistent neither with the legislative intent, nor with the effectuation of the purposes it is intended to serve." *Id.* at 424.

An analysis of *Barbour* and the legislation in question is illuminating. In enacting SIPA and the section granting to the SEC a right of action to sue for enforcement, Congress obviously: identified the duty—SIPC's obligation to protect customers; considered the possible wrong to the class by reason of SIPC's alleged wrongful failure to exercise its obligations; and consciously fashioned a remedy to redress the wrong, by taking what might ordinarily be a private right and placing it in the hands of public officials in order to further the effectuation of SIPA's overall purpose.[38]

The obvious distinction between these decisions and the case at bar is that in each case a cause of action identical to that being sought by the plaintiffs by implication, *i.e.*, the right to sue for enforcement, was expressly provided for in the Act in favor of persons other than plaintiffs. Equally significant, in both *Amtrak* and *Barbour* a remedy was provided for wrongs to the protected class; indeed, one of the reasons for declining to imply a private right

[38] As the Court explained it, SIPC possesses singular expertise as to what actions to take to avoid failure of a brokerage firm and when to take such actions ("SIPC properly treats an application for the appointment of a receiver and liquidation of a brokerage firm as a last resort," 421 U.S. at 421); with few exceptions, merely filing an action predicated on allegations of financial security could prove fatal to a broker; and, in marked contrast to SIPC, "[a] customer . . . cannot be expected to consider, or have adequate information to consider, these public interests in timing his decision to apply to the courts." *Id.* at 422.

of action of enforcement was the belief that the public officials would more effectively insure enforcement to the general benefit of the protected class. A denial of a private right of action in this case, however, would leave the intended beneficiaries of the statute without a remedy for wrongs the statute was designed to protect against.

Touche Ross also contends that the doctrine of *expressio unius est exclusio alterius*—which was referred to in *Amtrak*—compels a finding that Congress intended Section 18(a) to be the sole remedy for violations of Section 17(a). Petitioner's Brief at 41-43. This argument suffers from the same infirmities as the arguments discussed above. As this Court noted in *Cort:*

> "In *Amtrak*, there was a private cause of action *provided* in favor of certain plaintiffs *concerning the particular provision at issue.* It was *in this context* that we referred to '[a] frequently stated principle of statutory construction . . . that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies.' 414 U.S., at 458. In addition, there was specific support in the legislative history of the Amtrak Act for the proposition that the statutory remedies were to be exclusive. *Id.*, at 458-461." 422 U.S. at 83 n.14 (emphasis added).

Beyond its erroneous assertion as to the applicability of the *expressio unius* maxim to the instant situation, Touche Ross contends that because of the existence of Section 18(a) there must be " 'clear contrary evidence of legislative intent' to create an implied Section 17(a) remedy . . . to overcome the application of the *expressio unius* doctrine . . . ." Petitioner's Brief at 43. This assertion is, of course, directly in conflict with this Court's teaching in

Cort that "in situations where it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private right of action . . . ." 422 U.S. at 82.

(c) *Nothing In Blue Chip Stamps Suggests That A Private Right Of Action Should Not Be Implied Here*

Touche Ross also contends that the implication of a private right of action under Section 17(a), in light of the existence of Section 18(a), would conflict with *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). Petitioner's Brief at 43-45. Touche Ross points to the conclusion reached by this Court in *Blue Chip Stamps,* that "[i]t would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for *comparable* express causes of action." 421 U.S. at 735-36 (emphasis added). However, that conclusion resulted from the following predicament: both Sections 10(b) and 18(a) of the 1934 Act were, on their face, addressed to the protection of purchasers or sellers of securities caused injury by reason of false or misleading statements; yet, Section 18(a) provided for an *express* right of action, whereas the right of action under Section 10(b) had been judicially *implied;* and notwithstanding that Section 18(a) contained a stringent purchaser-seller requirement, it was urged upon the Court that Section 10(b) should not. No such predicament is created by Section 17(a). It is simply not intended to protect purchasers or sellers of securities; it is intended to protect the customers of broker-dealers. Consequently, it simply *cannot* be said about Sections 17(a) and 18(a), as was said in *Blue Chip Stamps* about Sections 10(b) and 18(a), that those sections are "comparable". No "anom-

aly" is created by implying a right in favor of brokers' customers.

Touche Ross also argues that the Section 17(a) claims of Weis' customers "are exactly the kind of speculative and unreliable claims that *Blue Chip Stamps* held are, and should be, excluded by the purchaser-seller requirements." Petitioner's Brief at 48. This statement is false and the argument misleading. In *Blue Chip Stamps,* the Court expressed concern over speculative and unreliable claims based on oral testimony by persons who had neither purchased nor sold a security and who could falsely claim that they made an investment decision based on a particular statement. 421 U.S. at 742-46. No such problem or similar problem exists with customers' claims under Section 17(a).

As to the argument that the claims involve questions of what remedial action would have been taken if Touche Ross had not made false certifications, such questions regarding causation and proof thereof are commonplace in litigation and in no way "raise precisely the problem that *Blue Chip Stamps* says must be avoided." *See* Petitioner's Brief at 49.

3. *Recognition Of A Private Right Of Action Under Section 17(a) Is Consistent With The Underlying Purposes Of The 1934 Act, And Is Necessary To Effectuate The Purposes Of The Section*

The third factor to be considered with respect to whether a private right of action should be implied is whether it is "consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?" *Cort* v. *Ash,* 422 U.S. at 78.

No one seriously quarrels with the fact that implication of a private right of action on behalf of customers is consistent with the broad disclosure purposes of the 1934 Act in general and the customer protection provisions of Sections 8, 15 and 17 in particular. Moreover, it bears more than passing observation that recognition of a private right of action under Section 17(a) and Rule 17a-5 is entirely consistent with the underlying purposes of SIPA which was enacted "to provide greater protection for customers of registered brokers and dealers . . ."[39] and had as one of its principal purposes "a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss."[40] H.R. Rep. No. 91-1613, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5254, 5255.

Nevertheless, Touche Ross, in its one page analysis of the *Cort* factors, argues that this third factor is not met because "an implied right of action would not be consistent with the legislative scheme, since it would effectively abolish the purchaser-seller limitation that Congress placed on express damage remedies." Petitioner's Brief at 67.

This argument is deficient for reasons already discussed at pp. 33-37 *supra.* As noted earlier, the purpose of Section 17(a) is to protect investors *qua* customers, and an implied right for such investors would not abolish the purchaser-seller requirement for investors seeking relief *qua* investors in securities. This is not a situation wherein a plaintiff has a remedy under Section 18 but is seeking to use an implied

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[39] *See* S. Rep No. 1218, 91st Cong., 2d Sess. 1 (1970). *See generally SIPC* v. *Barbour,* 421 U.S. 412, 415 (1975).

[40] This was accomplished by amending Section 15(c)(3) of the 1934 Act, which on its face applied only to over-the-counter broker-dealers, to cover all broker-dealers; and by further amending that section, which conferred general rulemaking authority on the Commission, to specify that that authority extends to rules relating to the protection of customers' securities and credit balances. Section 15(c)(3) of the 1934 Act was amended by Section 7(d) of SIPA.

remedy to circumvent its requirements. As the Court of Appeals noted:

> "Our holding is not inconsistent with either the purchaser-seller limitation or section 18, which will continue to apply to all investors in market securities who seek relief *qua* investors. That is, the *Blue Chip* doctrine would bar a suit by an investor who claimed to have been induced *not* to purchase or sell by a misstatement. We do not believe, however, that the doctrine applies to brokers' customers, protection of whom is wholly independent of protection of investors per se." (A. 201)

It is the very fact that the express remedies of the Act are limited to purchasers and sellers, and thus do not provide relief to other persons protected by the Act, such as customers, that makes it appropriate to imply a private right of action on behalf of customers. In this respect the case is similar to *Allen* v. *State Board of Elections*, 393 U.S. 544 (1969).[41]

The weakness in Touche Ross' argument regarding this third *Cort* factor is further exposed by reference to the two decisions discussing this factor which Touche Ross contends are "controlling."

[41] *Allen* dealt with the Voting Rights Act of 1965, which required that any new state laws passed regarding voting rights would be subject to approval procedures prior to implementation. Although the Act did not provide for an express right of action on behalf of private citizens, the Act stated that "no person shall be denied the right to vote for failure to comply with [an unapproved state enactment]." Although the Act did not provide for an express right of action on behalf of private citizens, this Court cited *Borak* and stated that the Act's goals would be severely hampered if an action were not implied and the citizens had to depend on the Attorney General who had the power to bring action at his discretion. This Court implied a right of action since the purpose of the Act was to protect a class of citizens, and absent such right of action, such protection would be ineffectual.

In *Amtrak* the Court concluded that implying a private right of action in favor of passengers affected by the discontinuance of passenger trains would "completely undercut the efficient apparatus that Congress sought to provide for Amtrak to sue in the 'paring of uneconomic routes.'" 414 at 453.[42] Similarly, in *Barbour* the Court declined to imply a private right of action because "as in *Amtrak*, it is clear that the overall structure and purpose of the SIPC scheme are incompatible with such an implied right." 421 U.S. at 421.[43]

A review of the Court's application of this third factor in *Piper* is equally illuminating. There the Court concluded that awarding damages to an unsuccessful tender offeror would not necessarily redound to the direct benefit of the protected class—shareholders of the *target* corporation—and indeed might be to their detriment. As the Court explained, although a monetary award to the unsuccessful bidder would indirectly benefit the shareholders of the target corporation who had exchanged their shares for those of the unsuccessful bidder, a damage award against the successful bidder would be detrimental to the shareholders of the target corporation who had exchanged their shares for the stock of the successful bidder. 430 U.S. at 39.

Actually, implication of a private right of action under Section 17(a) would not only be consistent with the underlying purposes of the 1934 Act, but is necessary to effectuate the purpose of Section 17(a).

In discussing this third factor, *Cort* quotes *Borak* as follows: "'[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose,' *J. I. Case Co.* v. *Borak*, 377 U.S., at

[42] The discussion of this holding appears *supra* at 37-38.

[43] The discussion of this holding appears *supra* at 38-39.

433, in this instance the remedy sought would not aid the primary congressional goal." 422 U.S. at 84.

Touche Ross, however, contends that *Piper* "'adds a significant gloss'" to *Cort* in regard to the "necessity factor." Petitioner's Brief at 59 n.32. Quoting from *Piper* —but putting its own gloss on the quote by adding the word "only"—Touche Ross argues that "a remedy can be regarded as 'necessary' only 'where *congressional purposes are likely to be undermined* absent private enforcement' (emphasis added). 430 U.S. at 25." Petitioner's Brief at 60.

What Touche Ross is suggesting is that the necessity factor is such that a party must be denied a right of action if he is unable to establish that effectuation of the congressional goals is not possible without a private remedy, *notwithstanding* that he has established:

(a) that he is a member of the class for whose special benefit the statute was enacted;

(b) that the duty owed him under the statute has been breached by the defendant to his damage;

(c) that there are no indications of legislation intent to deny a private right of action; and

(d) that implication of a private right of action would be consistent with the legislative scheme and is necessary to effectuate congressional goals *e.g.*, would "aid" or "further" such goals or would be a "necessary supplement" to Commission action.

Such a test would require that this Court conclude that the congressional scheme is to fragile, so imperfect, presumably so ill planned, that the legislative purpose would fail without a private right of action.

Nothing this Court has said before or since *Piper* suggests such a stringent and unrealistic test and it is respectfully submitted that this Court did not create such a test in *Piper*. The phraseology that this Court has consistently employed is "necessary to effectuate" congessional goals or "necessary supplement" to SEC enforcement.[44] Indeed, in describing the issues before it, *Piper* stated:

> "Against this background we must consider whether § 14(e), which is entirely silent as to private remedies, permits this Court to read into the statute a damages remedy for unsuccessful tender offerors. To resolve that question we turn to the legislative history to discern the congressional purpose underlying the specific statutory prohibition in § 14(e). Once we identify the legislative purpose, we must then determine whether the creation by judicial interpretation of the implied cause of action asserted by Chris-Craft is necessary to effectuate Congress' goals." 430 U.S. at 26.

Piper never reached the necessity question because it found that the legislative purpose of Section 14(e) was to protect shareholders of target companies and not unsuccessful offerors.

As to *Piper's* use of phraseology including "undermined", the Court was referring to the reasoning in *Borak* and *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). That Touche Ross is forcing a too stringent interpretation on these words is clear from a review of the language actually used in *Borak* and *Superin-*

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[44] *See Borak*, 377 U.S. at 433, *Blue Chip Stamps*, 421 U.S. at 730 ("the Court's recognition in *J. I. Case Co.* v. *Borak* . . . that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'"); *Rondeau* v. *Mosince Paper Corp.*, 422 U.S. 49, 62 (1975) ("[W]e have not hesitated . . . to fashion private remedies for securities laws violations when to do so is . . . necessary for the protection of investors as a supplement to enforcement by the Securities and Exchange Commission.")

tendent of Insurance, and by the juxtaposition by Touche Ross of the word "only" with the quote from *Piper. See* Petitioner's Brief at 60.

In the instant case an implied right of action would serve as a necessary supplement to SEC action for much the same reasons as in *Borak.*[45] The Court of Appeals so found.[46]

Moreover, an implied right of action for violations of Section 17(a) would undoubtedly result in a necessary deterrent against further abuses by brokers' accountants.[47]

[45] This case and *Borak* have in common the fact that they both involve a right of action asserted under the statute on behalf of its clearly intended beneficiaries—the proper persons to fill the void created by the SEC's institutional limitations. In *Piper,* on the other hand, the right of action was asserted not by a member of the class the statute intended to protect but a member of the class it sought to regulate, and consequently the SEC's institutional limitations were not relevant, nor did they in and of themselves provide a reason for implying a remedy. As this Court there pointed out: "[I]nstitutional limitations *alone* do not lead to the conclusion that *any party interested* in a tender offer should have a cause of action for damages against a competing bidder." 430 U.S. at 41 (emphasis added, footnote omitted).

[46] The Court of Appeals further explained:

> "In its *amicus brief,* the SEC advises us that, in fiscal 1976, over 5000 brokers and dealers were registered with it; that each of the approximately 750 broker-dealers that are not members of self-regulating organizations must be audited annually, as must the 500 or so against whom complaints are lodged; and that this leaves the SEC able to examine each year the statements of only 5% of broker-dealers who are apparently untroubled members of self-regulatory organizations." (A. 199 n.12).

[47] Touche Ross suggests that deterrence is no more of a proper consideration in this case than it was in *Piper.* Petitioner's Brief at 60. However, in *Piper* the Court noted that (a) "a monetary remedy . . . would not redound to the direct benefit of the protected class" (shareholders of target companies) and would actually harm those shareholders who exchanged shares for the shares of the successful bidder, and (b) shareholders will "more likely . . . be prejudiced" because risk of damage awards might deter tender

(Footnote continued on next page)

There is ample documented evidence of the fact that "independent" public accountants have not in fact acted independently in certifying their clients' financial reports. Thus, for example, in the "Report on the Auditors of Wall Street," which was based on the examination under oath of scores of individuals engaged in brokerage accounting and on the analysis of over a thousand in-depth questionnaires, the authors bluntly conclude that:

> "The stated opinions of auditors contained on balance sheets of brokers prepared for customers to peruse have, in many instances, been deceptive, avoided essential footnotes, and have been aimed more at showing a purported good financial health of a client rather than a true financial condition consistent with the auditor's responsibility." *Appendix F of the Hearings of the House Subcommittee on Interstate and Foreign Commerce,* 92d Cong., 1st Sess. 1091 (1971).
>
> "By the end of our initial study, we could without hesitation conclude that far too much management influence pervaded the auditing function in the securities business. This element constitutes the greatest possible danger to the investing public, and the securities market place." *Id.* at 1092.

In light of the strong criticism already directed against a significant segment of the accounting profession for their failure to comply with their responsibilities under the securities laws, it can hardly be concluded that existing remedies have been adequate to ensure the full effectiveness of Section 17(a). In these circumstances, the neces-

(Footnote continued from preceding page)

offers. 430 U.S. at 39, 40. Here, on the other hand, the threat of Section 17(a) actions by brokers' customers against brokers' accountants can have only therapeutic virtues, and would in no way "prejudice" the intended beneficiaries of the statute's protection.

sity of recognizing a private right of action under Section 17(a) to promote full and accurate review and certification so that customers and regulatory agencies can act *before* financial loss occurs becomes compelling.

These additional reasons make it necessary that a private right of action under Section 17(a) against accountants be available to brokers' customers. Not only did the Court of Appeals correctly recognize the existence of such an action, it also pointed out that "[n]either SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost." (A. 199).[48]

4. *Enforcement Of Section 17(a) Is Properly A Matter Of Federal, Not State, Concern*

The fourth *Cort* factor requires a consideration of whether "the cause of action [is] one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law." 422 U.S. at 78.

As previously demonstrated, pp. 8-11 *supra,* Section 17(a) and Rule 17a-5 constitute the cornerstone for the protection of investors who entrust their cash or securities to brokerage firms doing business on the national securities markets. Accountants who undertake to perform Section 17(a) obligations for brokerage firms do so with the knowledge that the very effectiveness of the federal regulatory system designed to protect these investors depends upon how the accountants perform their obligations. When the accountants seriously fail in their crucial duties (as Touche Ross did), the consequences can be national in scope and necessarily affect the federal regulatory system itself.

[48] *Cf. Wyandotte Transportation Co.* v. *United States,* 389 U.S. 191, 202 (1967) (noting that punishment of a wrong-doer is hardly a satisfactory remedy for a pecuniary injury).

Thus, an accountant's breach of its Section 17(a) duties is principally a matter of federal, and not merely of state, concern. As Congress explicated in Section 2 of the 1934 Act:

> "[T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto . . . ."

The Court of Appeals recognized that "[t]here is no reason to believe that the remedy sought herein is one traditionally relegated to state law." (A. 200). Exclusive federal court jurisdiction is already provided by Section 27 of the 1934 Act for "all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder." And, as this Court has proclaimed, "where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done." *Bell* v. *Hood,* 327 U.S. 678, 684 (1946) (footnote omitted). Accordingly, it would be wholly appropriate to recognize a federal cause of action based on Section 17(a) itself.

Indeed, the recognition of such a right of action is more than appropriate; it is essential. The availability of state court remedies to brokerage firm customers against brokerage firm accountants may be more theoretical than real. The substantive standards and the privity requirements under state law can impede the vindication of customers' rights, *see, e.g., Ultramares* v. *Touche, Niven, Bailey & Smart,* 255 N.Y. 170 (1931), thus making state remedies inadequate to effectuate the congressional purpose underiying Section 17(a).

Moreover, the laws of the states are varied with respect to customers' rights against accountants. Consequently, for the sake of uniformity, a federal right of action under Section 17(a) should be recognized. For, as the Court of Appeals stated, "it is evident that just as the problems caused by insolvent brokers are national in scope, so must be the standards governing their reporting." (A. 200). *See J. I. Case Co.* v. *Borak,* 377 U.S. at 434 ("[I]f the law of the State happened to attach no responsibility to the use of misleading proxy statements, the whole purpose of the Section [14(a)] might be frustrated."); *Bivens* v. *Six Unknown Federal Narcotics Agents,* 403 U.S. 388, 409 (1971) ("[T]here is very little to be gained from the standpoint of federalism by preserving different rules of liability for federal officers dependent on the State where the injury occurs.")

E. *Policy Considerations Do Not Militate Against Implying A Private Right Of Action Under Section 17(a)*

Touche Ross argues that apart from the question of whether a private right of action should be recognized under the standards set forth in *Cort* v. *Ash* and related cases, policy considerations "militate" against recognition of a private right of action in this case. Petitioner's Brief at 71-78. These ostensible policy considerations are, according to Touche Ross: (1) Congress, rather than the judiciary, should address this issue; (2) a private right of action would burden the federal courts with litigation that should be relegated to state courts; (3) the absence of the purchaser-seller requirement would increase the danger of vexatious litigation; and (4) the implication of a private right of action would give impetus to efforts to imply similar rights under different reporting provisions.

With respect to the first policy argument raised by Touche Ross, there is simply no reason why this case is any less suited for judicial determination than cases arising under Sections 10(b) and 14(a) of the 1934 Act or cases arising under the many other provisions of the securities laws which the lower courts have recognized as giving rise to implied actions.[49] The federal courts traditionally fashion remedies for violations of federally secured rights, particularly, where, as here, there is a general grant of authority to sue (Section 27). As stated in *Borak*:

> "It is for the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded. 'And it is also well settled that where legal rights have been invaded, and a federal statute provides for a *general* right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.' *Bell* v. *Hood,* 327 U.S. 678, 684 (1946)." 377 U.S. at 433 (emphasis added).

The claim that accountants will become insurers of the success of the entire regulatory scheme is specious. Peti-

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[49] *See Franklin National Bank* v. *L. B. Meadows & Co.,* 318 F. Supp. 1339, 1341-42 (E.D.N.Y. 1970). *See also Wilson* v. *First Houston Investment Corp.,* 566 F.2d 1235 (5th Cir.), *cert. pending,* 46 U.S.L.W. 3766 (June 7, 1978); *Lewis* v. *Transamerica Corp.,* 575 F.2d 237 (9th Cir.), *cert. granted,* 47 U.S.L.W. 3310 (Nov. 7, 1978); *Abrahamson* v. *Fleschner,* 568 F.2d 862 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978); *Dann* v. *Studebaker-Packard Corp.,* 288 F.2d 210 (6th Cir. 1961); *Goldstein* v. *Groesbeck,* 142 F.2d 422 (2d Cir.), *cert. denied,* 323 U.S. 737 (1944); *Hofmayer* v. *Dean Witter & Co. Inc.,* 459 F. Supp. 733 (N.D. Cal. 1978); *Kerber* v. *Kakos,* 383 F. Supp. 625 (N.D. Ill. 1974); *Kroese* v. *Crawford,* [1961-64 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,262 (S.D.N.Y. 1963); *Reader* v. *Hirsch & Co.,* 197 F. Supp. 111 (S.D.N.Y. 1961); *Hawkins* v. *Merrill, Lynch, Pierce, Fenner & Beane,* 85 F. Supp. 104 (W.D. Ark. 1949).

tioner's Brief at 73-74. If an auditor falsely certifies a broker's Section 17(a) report with a consequent loss to customers, the auditor will be held responsible because he is a primary wrongdoer.

Touche Ross' concern over the existence of liability in an indeterminate amount for an indeterminate time to an indeterminate class, is more imagined than real. The amount will always be measurable and concrete, and would normally be no greater than in class actions brought on behalf of purchasers and sellers against accountants who, for example, prepare and certify false registration statements. The time will be determined by general principles of limitation and the class will simply be the customers of the brokerage firm and those who sue on their behalf.

As to the second "consideration," the question of "burdening" the federal courts hardly comports with the principle that where suits are brought on behalf of federally protected parties for violation of federally established rights, federal courts should be alert to adjust their remedies so as to grant the necessary relief. *See, e.g., Santa Clara Pueblo* v. *Martinez,* 46 U.S.L.W. 4412 (May 15, 1978) (White, J., dissenting); *Bell* v. *Hood,* 327 U.S. 678, 684 (1946); *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282, 288 (1940). Moreover, although Touche Ross notes that between 1970 and 1977, 128 brokerage firms failed and were placed in SIPA liquidation, Touche Ross does not mention that this is only the first action SIPC has commenced against accountants arising from these liquidations.

Third, there is no reason to believe that the absence of the purchaser-seller requirement would present a problem of vexatious litigation by customers of bankrupt brokers. The customers who have actually lost cash or securities

in a failed brokerage house are an easily identifiable and ascertainable class, contrasted with the non-purchaser/non-seller investor who could falsely claim damage by reason of a purported decision not to buy or sell, the situation confronting this Court in *Blue Chip Stamps.* Moreover, the decision to institute suit to recover funds expended by SIPC is made by a corporation which is established by Congress, has a board of directors consisting of two designees of high level government officials and five presidential appointees, and is subject to extensive oversight by the SEC as well as to congressional scrutiny. The danger that it will institute frivolous actions is nonexistent. Moreover, since most claims of investors, including all the claims of small investors, are now paid by SIPC, there is little danger that the customers of insolvent broker-dealers will institute class action "strike" suits having little merit but, perhaps, some settlement value. All this is borne out by eight years of SIPA history.

Finally, finding an implied right for *customers* under Section 17(a) will set no precedent for implying a right of action for investors under the different reporting sections which, unlike Section 17(a), involve issuers and their purchaser-sellers. This is not a case such as those discussed in Petitioner's Brief at 36-37, 53, involving a statute, such as Section 13(a) which involves reporting by issuers or purchasers of stock.

II

The Court Of Appeals Correctly Held That SIPC Is Subrogated To Weis' Customers' Section 17(a) Right Of Action Against Touche Ross.

Upon Weis' liquidation and pursuant to SIPA, SIPC advanced funds to the Trustee for the satisfaction (within certain statutory limits) of the claims made against Weis' estate by Weis' customers. On the basis of the fundamental common law doctrine of equitable subrogation, SIPC succeeds to the rights which Weis' customers could have asserted against Touche Ross, the wrongdoer, had their claims not been satisfied.[50] Accordingly, having earlier held that Weis' customers have a right of action under Section 17(a) against Touche Ross, the Court of Appeals held that SIPC is subrogated to this Section 17(a) right of action because

> "'[T]he general rule is that upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss.' 31 N.Y. Jur., *Insurance* § 1620, at 510." (A. 202).[51]

[50] Of course, SIPC is subrogated only to the extent that the SIPC fund was depleted to satisfy the claims. To the extent customer claims exceeded the limits prescribed in SIPA, they were not satisfied from the SIPC fund.

[51] The doctrine has been described as follows:

> "Subrogation, an equitable doctrine taken from the civil law, is broad enough to include every instance in which one party pays a debt for which another is primarily answerable and which in equity and good conscience should have been discharged by the latter, so long as the payment was made either under compulsion or for the protection of some interest of the party making the payment, and in discharge of an existing liability." *Gerseta Corp.* v. *Equitable Trust Co.*, 241 N.Y. 418, 425 (1926).

The decision below accords with the view adopted in the only other case which has referred to the question of SIPC's subrogation rights. *SEC* v. *Albert & Maguire Securities Co.*, 560 F.2d 569, 574 (3d Cir. 1977) ("[U]pon payment to a customer, SIPC becomes subrogated to the customer's rights against third parties.")

Touche Ross contends, however, that SIPC has no such common law subrogation right because, as Touche Ross would have it, SIPC's "exclusive subrogation remedy" is the one provided in Section 6(f)(1) of SIPA.[52] Touche Ross surmises that this is what "Congress clearly intended," which serves as a prelude to Touche Ross' by now familiar *expressio unius* argument. Petitioner's Brief at 101.

Nothing in the SIPA statute or in its legislative history even suggests that Congress intended, either explicitly or implicitly, that SIPC's statutory subrogation right would be its sole and preclusive subrogation remedy. In fact, the statute itself indicates that Congress intended just the opposite. Thus, Section 2 of SIPA provides:

> "Except as otherwise provided in this Act, the provisions of the Securities Exchange Act of 1934 . . . apply

[52] Section 6(f)(1) of SIPA provides:

> "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section."

Touche Ross asserts that under this section SIPC is subrogated only to customer "claims" (but not causes of action) and only against Weis' estate (but not against third parties such as accountants), and that the Court of Appeals majority so "held". Petitioner's Brief at 100. In point of fact, the Court of Appeals merely noted, as was not contested below, that the section applies to claims *against the debtor's estate* (A. 201-02). The question of whether the word "claims" excludes causes of action was not even raised, much less decided, below.

as if this act constituted an amendment to, and was included as a section of, such Act."

And the 1934 Act, into which SIPA is thus incorporated, provides in Section 28(a):

"The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity. . . ."

Accordingly, the subrogation right in Section 6(f)(1) of SIPA was made available to SIPC *in addition to*, and not in abrogation of, SIPC's common law subrogation rights.

Moreover, Section 6(f)(1) must, of course, be viewed in the context in which it appears. It is a subsection of Section 6 which is headed "Liquidation Proceedings". As the Court of Appeals recognized:

"Section 78fff [Section 6 of SIPA] is a detailed blueprint for the distribution of the liquidated debtor's estate, and it is to be expected that SIPC's rights against the estate would be included in that section." (A. 202).

In direct contrast to Section 6, no comprehensive scheme is contained in SIPA with respect to customer rights *outside* the context of liquidation proceedings. Consequently, there was no need to define by statute the subrogation right to which SIPC would be entitled under the common law. Not even Touche Ross suggests that the common law right of liquidated brokers' customers to sue third parties is abrogated by SIPA. In fact, Section 6(g) recognizes that customers may have common law rights against third parties which are assignable to the trustee in liquidation. *See SEC* v. *Albert & Maguire Securities Co.*, 560 F.2d at 574. Just as the common law right of customers to sue third

parties is preserved by SIPA, SIPC's common law subrogation right is also preserved.

The flaw in Touche Ross' *expressio unius* contention is that it is predicated on the notion that, when Congress fixes by statute a particular right, its actual intention is to deny other equitable and common law rights. However, as this Court has pointed out, "the legislative grant of a new right does not ordinarily cut off or preclude other non-statutory rights in the absence of clear language to that effect." *Federal Marine Terminals, Inc.* v. *Burnside Shipping Co.*, 394 U.S. 404, 412 (1969).

Touche Ross' contention also ignores that:

"However well these rules [*expressio unius* and *ejusdem generis*] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350 (1943) (footnote omitted).

The "generally expressed legislative policy" here is to maximize SIPC's recovery of the funds it expends in the course of broker-dealer liquidation. Thus, for example, Section 6(c)(2)(B)(i) of SIPA provides:

[*T*]*here shall be repaid to SIPC, in priority to all other claims payable from such single and separate fund,* the amount of all advances made by SIPC to the trustee to permit the completion of open contractual commitments . . . ." (emphasis added).

Similarly, Section 6(c)(2)(B)(ii) of SIPA provides:

> "[A]ll costs and expenses specified in clauses (1) and (2) of section 64a of the Bankruptcy Act shall be paid from such single and separate fund in priority to the claims of such single and separate class of creditors, and *any moneys advanced by SIPC for such costs and expenses shall be recouped as such . . . .*" (emphasis added).

And of course, Section 6(f)(1) itself, far from abrogating SIPC's common law subrogation right, is yet another example of Congress' concern that SIPC recoup any losses it can.

Touche Ross suggests, however, that "the result of permitting SIPC to sue as 'subrogee' would be to transfer from SIPC . . . to a third party such as Touche Ross the burden of providing the financial protection to customers that Congress specifically created SIPC in order to provide." Petitioner's Brief at 105. This statement represents a callous denial of the fact that the burden of providing customer protection is squarely placed first and foremost on accountants such as Touche Ross because the very efficacy of the "early warning system" depends upon their performance of their Section 17(a) obligations. See p. 16 *supra*. This was so long before SIPC was created, and has remained so since. To infer that by enacting SIPA Congress relieved accountants of the legal effect of the breach of their pre-existing duty is simply ludicrous. As the Court of Appeals recognized, "it is more in keeping with the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC . . . ." (A. 202).

Touche Ross also asserts that permitting SIPC to sue as subrogee makes the "holding with respect to SIPC's entitlement to sue in its own right illusory" because, as

Touche Ross would have it, Congress intended to protect only customers, and subrogating SIPC to their claims benefits only SIPC. Petitioner's Brief at 104. However, even if the Court of Appeals' statement that it did "not reach" the question of SIPC's own right to sue were a "holding" (A. 201, n.13),[53] it hardly would refute the fact that by SIPA Congress created a financial mechanism (SIPC) for the protection of customers in the event the first line of defense (financial responsibility) should fail. It wholly comports with the congressional intent to create this mechanism that it remain available to the fullest extent possible to its intended beneficiaries (brokers' customers), and that it be replenished by those who might defeat the first line of defense (brokers' accountants). In addition, while Section 4(h) of SIPA authorizes a billion dollar line of credit from the federal Treasury to SIPC, Congress was concerned that the exposure of such United States funds be avoided.[54] The impact of such a borrowing would be felt not only by the members of SIPC but also by the investing public on whose transactions special assessments could be levied as part of the necessary plan to repay the borrowed funds. Finally, the importance of the amendment of Section 15(c)(3) of the 1934 Act by Section 7(d) of SIPA should be noted. The amendment broadened the SEC's powers as to financial responsibility rules, and required that such rules provide for the maintenance of

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[53] This is one of the issues raised in SIPC's conditional cross-petition for certiorari (No. 78-526), which is still *sub judice*. In its response to that petition, Touche Ross stated that it did not oppose the petition.

[54] This concern is reflected in testimony given at the hearings held in connection with the enactment of SIPA. *Hearings Before the Subcommittee On Commerce and Finance of the Committee On Interstate and Foreign Commerce on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109, and H.R. 18458*, 91st Cong., 2d Sess. 344-47 (1970).

reserves for customer deposits and credit balances. Thus, the amendment both intensified the congressional concern for the protection of brokers' customers *and* expanded the protected class to include SIPC itself.

Conclusion

For the foregoing reasons, as well as those set forth in the Trustee's brief, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX

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Statutes and Rules

Securities Exchange Act of 1934

Section 27, 15 U.S.C. § 78aa:

"Jurisdiction of Offenses and Suits."

"Section 27. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts."